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**Federal Communications Commission
Office of Secretary**

**STATE OF INDIANA
UTILITY REGULATORY COMMISSION**

**IN THE MATTER OF THE INVESTIGATION)
ON THE COMMISSION'S OWN MOTION)
INTO ALL MATTERS RELATING TO THE)
MERGER OF AMERITECH CORPORATION)
AND SBC COMMUNICATIONS INC.)**

CAUSE NO. 41255

**REBUTTAL TESTIMONY OF
ROBERT G. HARRIS**

JUNE 25, 1999

I. QUALIFICATIONS, PURPOSE AND ORGANIZATION OF TESTIMONY

Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A1. Dr. Robert G. Harris, LECG, Inc., 2000 Powell Street, Emeryville, CA 94608.

Q2. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL QUALIFICATIONS.

A2. I am a Principal in the Law and Economics Consulting Group and Professor Emeritus of Business and Public Policy in the Haas School of Business, University of California, Berkeley. I earned Bachelor of Arts and Master of Arts degrees in Social Science from Michigan State University and Master of Arts and Doctor of Philosophy degrees in Economics from the University of California, Berkeley. At Berkeley, I teach a graduate course in "Telecommunications Economics, Policies and Strategies," and have taught courses at the undergraduate, MBA and Ph.D. levels, in Antitrust and Economic Regulation, Managerial Economics, Business and Public Policy, Competitive Strategy, Transportation and Corporate Governance. I have also taught competitive strategy and telecommunications in Executive Education programs for business managers and public officials from the United States and abroad at UC Berkeley and the University of Southern California.

My academic research has analyzed the effects of economic regulation and antitrust policy on industry performance, and the implication of changing economics and technology for public policies in transportation and telecommunications. I have published dozens of academic articles on antitrust policy, regulatory policy, telecommunications policy, technological innovation, the economics of

1 telecommunications and transportation, and the development of competition and
2 interconnection policies in local access and exchange services. My academic articles on
3 antitrust market definition served as the basis for the market definition approach in the
4 Merger Guidelines of the National Association of Attorneys General.

5 As an advisor to the U. S. Department of Transportation from 1976-79, I assisted in the
6 drafting of legislation that was passed by Congress in 1980, reforming regulation of the
7 motor carrier and railroad industries. While on leave from the University of California in
8 1980-81, I served as a Deputy Director for Cost, Economic and Financial Analysis at the
9 Interstate Commerce Commission. At the I.C.C., I was centrally involved in the major
10 rule makings implementing the motor carrier and railroad regulatory reform acts of 1980
11 and directed the development of the Uniform Rail Costing System. I have also served as
12 a consultant to the U.S. General Accounting Office, the U.S. Office of Technology
13 Assessment, the U.S. Department of Justice, the California Attorney General and the
14 California Department of Consumer Affairs. I recently advised the Economic Planning
15 Agency of Japan on the reform of Japanese telecommunications policies.

16 I have testified on costing methods and principles, pricing principles and rate design,
17 competition policy, interconnection policy and spectrum policy before Federal and
18 numerous state regulatory commissions. I have also testified before the national
19 telecommunications regulatory authorities in Canada and Mexico and before the United
20 States Senate, the United States House of Representatives and the Joint Economic
21 Committee of Congress on transportation, antitrust and telecommunications policy issues.
22 I have testified before this Commission on numerous occasions, including the dockets

1 related to Ameritech Ohio's Alternative Regulation Framework and the establishment of
2 permanent TELRIC rates for unbundled network elements in Docket No. 96-922-TP-
3 UNC.

4 **Q3. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

5 A3. SBC and Ameritech seek to merge in order to position their company for the dynamic
6 telecommunications marketplace of the future. The companies describe a variety of
7 genuine benefits that will flow from the merger, including strongly procompetitive ones.
8 These benefits will accrue both to Indiana and to the nation as a whole. Opponents of the
9 merger, many of whom are competitors of these merger partners, attempt to demean these
10 benefits and express fears regarding possible anticompetitive effects that they claim
11 would come from the merger. My rebuttal testimony addresses a number of the
12 arguments put forth by the IURC Staff and other opponents of the merger. In particular, I
13 address arguments espoused by the IURC Testimonial Staff, Residential Customers
14 witness Dr. Mark N. Cooper, AT&T witness Mr. Joseph Gillan, Sprint witness Mr. David
15 E. Stahly, and Indiana Office of Utility Consumer Counselor witnesses Lee L. Selwyn
16 and Susan M. Baldwin.¹ In my testimony, I show how all of these claims are bogus.

¹ IURC Testimonial Staff Report, *In the Matter of the Investigation on the Commission's Own Motion into Any and All Matters Relating to the Merger of Ameritech Corporation and SBC Communications, Inc.*, IURC Cause No. 41255, June 22, 1999, pp. 3-17, (hereafter "IURC Staff Report"); Testimony of Dr. Mark N. Cooper on Behalf of Residential Customers, *In the Matter of the Investigation on the Commission's Own Motion into Any and All Matters Relating to the Merger of Ameritech Corporation and SBC Communications, Inc.*, IURC Cause No. 41255, June 22, 1999, pp. 16, 29-40, (hereafter, "Cooper"); Direct Testimony of Joseph Gillan on Behalf of AT&T Communications of Indiana, Inc., *In the Matter of the Investigation on the Commission's Own Motion into Any and All Matters Relating to the Merger of Ameritech Corporation and SBC Communications, Inc.*, IURC Cause No. 41255, June 22, 1999, pp. 4-22, (hereafter, "Gillan"); Direct Testimony of David E. Stahly, *In the Matter of the Investigation on the Commission's Own Motion into Any and All Matters Relating to the Merger of Ameritech Corporation and SBC Communications, Inc.*, IURC Cause No. 41255, June 22, 1999, pp. 6-44, (hereafter, "Stahly"); and Direct Testimony of Lee L. Selwyn and Susan M. Baldwin on Behalf of the Indiana Office of Utility Consumer Counselor (OUCC), *In the Matter of the Investigation on the Commission's*

1 They are based on flawed theories that do not withstand the scrutiny of economic analysis
2 and they have no basis in real world experience, i.e., these same concerns have been
3 raised before but have never been shown to be true or to have affected competition in the
4 marketplace.

5
6 My testimony discusses how a proper economic analysis, that used by the Department of
7 Justice and Federal Trade Commission and by the mainstream of economists, is
8 conducted. I then use that framework to show how the theories espoused by opponents in
9 this case do not meet these standards and are without merit.

10 **II. THE MAJORITY OF OPPONENTS' ARGUMENTS ARE IRRELEVANT TO**
11 **THE MERGER AT HAND**

12 **Q4. DO THE OPPONENTS DEMONSTRATE THAT THE MERGER WILL HARM**
13 **THE DEVELOPMENT OF COMPETITION IN INDIANA?**

14 A4. No. Several of the opponents contend that a merger between Ameritech and SBC
15 Communications will harm the development of competition in Indiana. A persistent flaw
16 in the arguments of opponents of the SBC-Ameritech merger is that the opponents either
17 fail to show any relation between the merger and the problems they allege, or they
18 espouse illogical and unsubstantiated theories as to the alleged effects the merger would
19 have.² The majority of the opponents' arguments are simply irrelevant in the context of
20 this merger. With regard to the fallacies contained in the opponents' other arguments, I

Own Motion into Any and All Matters Relating to the Merger of Ameritech Corporation and SBC Communications, Inc., IURC Cause No. 41255, June 22, 1999, (hereafter, "Selwyn/Baldwin").

² For example, Dr. Cooper insists that because the utility industry is not effectively competitive, there are additional concerns of market power abuse and that "mergers heighten these concerns." (Cooper, p. 16). However, Dr. Cooper gives no explanation whatsoever as to *how* a merger could heighten these concerns. Dr. Selwyn and Ms. Baldwin attribute anticompetitive effects of the merger to an increase in concentration in the theoretical "national" local market – a market that is nonexistent. (Selwyn/Baldwin, p. 66).

1 show how the theories are incorrect and how there is no real world support for their
2 assertions.

3 **Q5. WHAT IS THE ECONOMIC STANDARD FOR EVALUATING THE IMPACT**
4 **OF THIS MERGER ON COMPETITION IN INDIANA?**

5 A5. A merger analysis should be based on the effect that the merger will have on consumers
6 and the economy at large. The focus should be on consumers because they represent the
7 public interest.³ In analyzing the merger at hand, the focus should be on whether the
8 merger is likely to harm consumers by resulting in higher prices or reduced quality of
9 telecommunications products and services, and, if so, whether any such risks outweigh
10 the expected benefits from the merger. At the outset of a merger analysis, it is essential
11 that one first identify the relevant market or markets that could be affected by the merger.

12 **Q6. HOW WOULD YOU DEFINE THE RELEVANT MARKET IN THIS MERGER**
13 **PROCEEDING?**

14 A6. Any market in which Ameritech and SBC, individually or together, currently participate
15 can be a relevant market for performing a merger analysis. Thus, the relevant market, in
16 this context, is primarily any individual local market in which one or both of the joint
17 applicants participate. However, it is imperative to accept the fact that local markets are,
18 by definition, local. Attempting to measure market concentration and market power in

³ All too often, the opponents attempt to further their own goal to protect competitors, rather than the goal of regulation which is to protect consumers. For example, Dr Cooper claims that the underlying scale and scope economies that the merged firm will achieve are unfair to other competitors, while in reality, these scale and scope economies are precisely the kinds of benefits that consumers stand to gain from the merger and should be considered a positive result of the merger, not a negative one. (See Dr. Cooper, p. 37) Similarly, Mr. Gillan claims that it is unfair to other competitors that SBC-Ameritech will be able to offer service as a single provider across multiple locations. (Gillan, p. 10) Ironically, that ability is exactly why this merger will benefit, not harm, consumers.

1 *local* markets at a *national* level as many of the opponents of the merger attempt to do⁴ is
2 nonsensical. To use a national market as a basis for this merger analysis is to assume that
3 local service in one geographic market is an effective substitute for local service in
4 another geographic market – an assumption that defies common sense.

5 **Q7. WILL THE MERGER HAVE ANY EFFECT ON AMERITECH INDIANA'S**
6 **MARKET POWER IN ANY RELEVANT MARKET?**

7 A7. No. This merger cannot possibly increase the market power of the joint applicants in
8 Indiana because SBC does not compete in any relevant local market in Indiana. As many
9 of the opponents recognize, the Department of Justice (DOJ) typically uses a Herfindahl-
10 Hirschman Index (HHI) as one element in measuring the effect of a merger on
11 competition.⁵ However, calculating such a measure in the case of the merger at hand, as
12 the opponents attempt to do,⁶ is a meaningless exercise. A merger can result in an
13 increase in the HHI in a relevant market only if both firms compete in that market. For
14 example, the HHI is calculated by summing the squares of the market shares of all of the
15 participants in a relative market and measuring the increase in the HHI as a result of a
16 merger. Given that SBC's market share is *zero* in Indiana, the pre- and post-merger HHIs
17 resulting from this merger are *identical*. Indeed, SBC and Ameritech do not belong
18 together in the calculation of the HHI for any relevant local market since they do not
19 compete. Attempting to throw SBC and Ameritech into the same market for the purpose

⁴ Cooper, p. 35; Gillan, p. 5.

⁵ Cooper, p. 34-35; Selwyn/Baldwin, p. 66.

⁶ Cooper, p. 35; Selwyn/Baldwin, p. 67.

1 of an HHI measure is purely self-serving. It serves no useful purpose from an economic
2 analysis standpoint.

3 **Q8. WILL THE SHEER SIZE OF SBC-AMERITECH INCREASE SBC-**
4 **AMERITECH'S MARKET POWER?**

5 A8. No. Many of the opponents provide extensive statistics on how large SBC-Ameritech
6 will be after the merger, implying that the sheer size of the company will somehow
7 increase SBC-Ameritech's market power or increase its ability to discriminate or harm
8 competition.⁷ As discussed above, this merger will not increase SBC-Ameritech's market
9 power in any relevant market because the two companies do not currently compete with
10 each other in any relevant market. Concerns about the absolute size of a combined SBC-
11 Ameritech fly in the face of both accepted antitrust principles and what is actually
12 happening in today's telecommunications marketplace.

13 As I discuss later, the participants in this industry, and those competing in Indiana, are
14 not small firms. Nor will this be an industry of small firms in the future, with the
15 possible exception of niche players. Firms are teaming up all across the country and the
16 world in order to position themselves for the competitive battle. This merger is distinctly
17 procompetitive and is completely consistent with the trend of strategies in the
18 marketplace. Absolute size is not a concern, especially since there is no anticompetitive
19 effect of the merger.

⁷ Cooper, p. 5.

1 **Q9. GIVEN THAT IT WILL NOT INCREASE MARKET POWER, WHAT IS THE**
2 **REAL MOTIVATION BEHIND THIS MERGER?**

3 A9. As mentioned above, the telecommunications industry is currently undergoing an
4 unprecedented transformation. Changes in the industry are substantially affecting
5 competition by reshaping many competitors' strategies and destroying old paradigms. It
6 is becoming increasingly clear that traditional local service providers in the industry must
7 adapt to the revolutionary changes in the industry in order to remain competitive. This
8 merger is in response to those changes.

9 By expanding geographically, improving efficiency and sharing knowledge, Ameritech
10 and SBC will become better able to adapt to the changes in the industry in order to meet
11 the evolving needs of customers. By becoming a more effective competitor, the merged
12 SBC-Ameritech will bring significant benefits to consumers and thus will promote the
13 public interest.

14 **Q10. WHAT EFFECT WILL THE MERGER HAVE ON THE DEVELOPMENT OF**
15 **LOCAL COMPETITION IN INDIANA?**

16 A10. The only impact that this merger can have on local competition in Indiana is a positive
17 one. A merger analysis begins by taking the current structure of the market as a given.
18 Given the current market conditions in Indiana, a merger between Ameritech Indiana and
19 SBC will not eliminate any competitor in either of the geographic areas served by the two
20 companies, will not increase concentration, and will not change any other entry or
21 competitive conditions. Ameritech Indiana will occupy the same place in the overall
22 market structure of Indiana as it does today. After the merger, Ameritech Indiana's
23 competitors will have the same incentives and ability to compete for customers as they

1 did before the merger. Several of those competitors are themselves very large
2 companies, significantly larger than a combined SBC-Ameritech will be. AT&T-TCG-
3 TCI-MediaOne-British Telecom, MCI-WorldCom and Sprint-Deutsch Telecom-France
4 Telecom are huge companies with a global reach, and in fact, through the greater scale
5 achieved by the merger, the combined SBC-Ameritech will be better able to compete
6 effectively with those companies. The merger will likely accelerate competitive entry in
7 Indiana in response to Ameritech Indiana's strengthened competitive position. Thus,
8 while the merger may in fact have a *positive* effect on the development of local
9 competition in Indiana, it is safe to say that the worst case scenario, in terms of local
10 competition, is that local competition will continue to grow at least as fast as it has in
11 recent years.

12 **III. ASSESSMENT OF COMPETITIVE ENVIRONMENT IN INDIANA**

13 **Q11. HAVE THE OPPONENTS CHARACTERIZED THE STATE OF COMPETITION**
14 **IN INDIANA ACCURATELY?**

15 A11. No. The opponents characterization of local competition in Indiana is that of a
16 competition-starved market.⁸ This is far from the truth. Indiana currently has seven
17 facilities-based CLECs currently competing in Indiana's local markets. These
18 competitors range from former competitive access providers that are now full-fledged
19 CLECs, cable companies, and newly formed CLECs. Table 1 shows who these
20 competitors are, where their switches are located and how many of Ameritech Indiana's
21 rate centers they currently can serve. While, as would be expected, Indianapolis is
22 included in local markets many of these competitors can serve, they by no means are

1 limited to that market. In fact, AT&T and Focal are serving areas of Indiana from
2 switches located in Chicago and AT&T is set to serve 43 rate center areas from its
3 Indianapolis switch. These rate centers are included in the count because AT&T, itself,
4 has included numbers for those rate centers in the local exchange routing guide (LERG)
5 used by all local carriers. Since these companies have invested in switching equipment
6 and infrastructure, as well as the resources required to make their networks operational, it
7 is evident that they are in the local business for the long haul. Furthermore, the bulk of
8 these companies are not unknown, ill-funded, start-ups. These competitors include large,
9 experienced telecommunications providers like AT&T and MCI WorldCom, along with
10 well-funded newer CLECs such as Time Warner, Focal and McLeodUSA. They can
11 hardly be dismissed as ineffective competitors to Ameritech Indiana.

⁸ IURC Staff Report, p. 7; Selwyn/Baldwin, p. 55-57.

1
2 These competitors are continuously expanding their competitive presence in Indiana and
3 targeting the most densely populated areas where Ameritech Indiana's revenues are most
4 vulnerable. As shown in Table 1, five of the seven facilities-based competitors in Indiana
5 have all of their switches located in Indianapolis and the surrounding cities including
6 Carmel, Fishers, and Greenwood. Not only is the rate center information discussed
7 earlier of great significance, that information is brought into even sharper focus when the
8 number of lines that can be served by competitors' switches is considered. Tables 2 and
9 3 show that while Indianapolis has competitive alternatives available for 84.9 percent to
10 92.6 percent of Ameritech Indiana's lines, the entire state has almost half (46.8 percent)
11 to 71.5 percent of Ameritech Indiana's lines currently vulnerable to competitors. The
12 lower bounds on these percentages consider only wire centers where collocation currently
13 exists while the upper bound includes all wire centers that can be served with the
14 assumption that collocation can be obtained. Clearly, these numbers stand in stark
15 contrast to the false minimization of existing competition contained in the IURC
16 Testimonial Staff Report and the testimony of other opponents.

1
2 In addition to these rather astounding facts on the status of current local competition in
3 Ameritech Indiana's territory, a map of Indianapolis and current competitors' networks is
4 also highly revealing. Figure 1 shows the virtually complete coverage of Indianapolis by
5 some competitors' fiber optic networks. Specifically, Time Warner currently has a fiber
6 network of approximately 300 miles in Indianapolis alone. The network consists of three
7 backbones which serve numerous distribution rings throughout the city as well as north
8 and west suburban areas, and "are expanding into the east suburban area."⁹ AT&T-
9 TCG's Indianapolis network runs through Indianapolis, Fishers, Carmel, and Greenwood,
10 spans 199 route miles and serves between 100 and 200 buildings.¹⁰ In addition,
11 McLeodUSA, through its recent merger with Ovation Communications, now has
12 approximately 412,000 local lines, 5,400 employees, 6,900 route miles of fiber optic
13 network, and 11 switches, including one in Indianapolis.¹¹ MCI WorldCom began
14 operating its Indianapolis network in 1995.¹² Its network now spans 160 route miles and
15 serves 35 buildings.¹³ With such extensive networks already in place and investment
16 already made, these competitors have an interest in expanding their presence in Indiana,
17 and the ability to do so quickly and easily.

⁹ See Time Warner Telecom Web site, Time Warner Telecom Fact Sheet – Indianapolis, Indiana, found at <http://www.twtelecom.com/TimeWarnerCities/Indiana/Indianapolis/factsheet.html>.

¹⁰ Teleport Communications Group, Inc. (TCG) Fact Sheet, see <http://www.tcg.com>. See also, Merger of SBC Communications Inc. and Ameritech Corporation: Description of the Transaction, Public Interest Showing and Related Demonstrations, Table 12.

¹¹ "Ovation Communications Merges With McLeodUSA Incorporated," *Ovation Communications Press Release*, January 8, 1999.

¹² See MFS-WorldCom, "The 1998 CLEC Report," *New Paradigm Resources Group*, MFS-WorldCom, p. 6.

¹³ Merger of SBC Communications Inc. and Ameritech Corporation: Description of the Transaction, Public Interest Showing and Related Demonstrations, Table 12.

1 Given the vivid and conclusive evidence given here, it is apparent that the opponents'
2 characterization of the local competitive landscape in Ameritech Indiana's territory is not
3 just misleading, it is in error. Facilities-based competitors have a substantial presence in
4 Ameritech Indiana's local markets. When assessing the possible impact of a merger on
5 competition in relevant markets, the first point of departure is the existing state of
6 competition and how that is affected by the merger. Clearly, there is competition now in
7 the marketplace and that competition is growing.

8 With respect to the description of a competitive marketplace, the IURC staff relies upon
9 economic positions totally outside the accepted body of economic literature and that have
10 no basis in economic theory or empirical analysis. First, the IURC staff places some
11 reliance upon four firm concentration ratios, the percent of the market collectively held
12 by the largest four firms in a market. Four firm concentration ratios provide almost no
13 information of economic value inasmuch as they totally ignore any other dimension of
14 market structure, including the disparities of firm sizes included within the measure. It is
15 precisely for this reason that the DOJ and Federal Trade Commission rely upon the more
16 sophisticated measure of the HHI, applied to relevant markets. The 60% four firm
17 concentration ratio description referenced by the IURC staff has not been accepted by the
18 antitrust or economic community and should not be given any weight here.¹⁴

19 A second significant error in this regard is the staff's reliance upon William Shepherd's
20 claim of the need for five competitors in a market for a market to be competitive. There

¹⁴ IURC Staff Report, p.5

1 is no theoretical or empirical support for such an opinion. No specific number has ever
2 been identified as the “right” number of firms for a market to be competitive, nor could
3 there be. Conditions in different industries and markets differ markedly, none of which is
4 taken into account in trying to pinpoint a magic number. Indeed, reliance upon HHIs by
5 governmental bodies and economists exists because of the recognized inability to fall
6 back on a simplistic numbers game. It just cannot be done. In fact, economic models
7 exist showing that two competitors may be adequate for competition to exist in a
8 marketplace. The main point, however, is that the Commission cannot rely upon an
9 arbitrary number, such as five, and base any sound public policy conclusions on it.

10 **Q12. HOW WOULD THE SBC-AMERITECH MERGER AFFECT POTENTIAL**
11 **COMPETITION IN INDIANA?**

12 A12. Many opponents claim that the merger will result in the removal of SBC as a potential
13 competitor.¹⁵ These claims are without merit. First, unlike many other companies who
14 are already providing telecommunications services in Indiana, SBC currently has no
15 assets, such as network facilities and brand name awareness in Indiana and is not
16 “uniquely situated” to enter that market. Second, there are many other actual and
17 potential entrants in Indiana so that even if SBC were a potential entrant, it would be one
18 of many, and the elimination of any individual entrant is unlikely to have any significant
19 impact on the price or quality of local service in Indiana. Indeed, if anything, the merger
20 will stimulate the rate of entry by those actual and potential competitors, thereby
21 increasing competition in Indiana.

¹⁵ Cooper, p. 30, 32, 38; Gillan, p. 27; Selwyn/Baldwin, p. 17.

1 **Q13. WHO ARE THE MOST LIKELY POTENTIAL ENTRANTS IN INDIANA'S**
2 **LOCAL MARKETS?**

3 A13. Many long distance carriers, cable companies, wireless companies, electric utilities and
4 competitive access providers all have existing assets in Indiana, such as network
5 facilities, brand name recognition, and a current customer base. These are the
6 competitors who have already entered Indiana's local markets and are the most likely
7 competitors to enter and expand into those markets in the future. SBC, however, has
8 none of these assets in Indiana and is unlikely to enter the market.

9 **Q14. WILL THE BENEFITS OF EFFICIENCY IMPROVEMENTS ACCRUE TO**
10 **INDIANA CUSTOMERS EVEN IF LOCAL COMPETITION HAS NOT FULLY**
11 **DEVELOPED?**

12 A14. Yes. First, it is important to realize that many of the benefits of cost and efficiency
13 improvements resulting from the merger will accrue directly to all customers in Indiana.
14 For example, improvements in repair and installation times as a result of increased
15 efficiencies from the merger will directly benefit consumers in Indiana, regardless of the
16 extent of competition in local markets.¹⁶ Second, many of the opponents seem to imply
17 that the only way SBC-Ameritech can pass through benefits to consumers is through
18 lowering basic local service rates.¹⁷ However, while it is my belief that local competition
19 in Indiana is developing at such a rate as to encourage Ameritech Indiana to compete
20 vigorously for customers, there is no mandate that the benefits of a merger be passed

¹⁶ SBC significantly improved quality in repair times for the Pacific Telesis area after its merger with Pacific Telesis. Post-merger repair times were reduced by an average of 60%. Installation times were reduced by 80% from as much as 2-3 weeks to 3-4 days. See the Direct Testimony of James S. Kahan on Behalf of SBC Communications, Inc., *In the Matter of the Joint Application of SBC Communications Inc., SBC Delaware Inc., Ameritech Corporation, and Ameritech Ohio for Consent and Approval of a Change of Control*, Ohio PUCO Docket No. 98-1082-TP-AMT, at 31.

1 through to customers solely through a basic local service market mechanism. Ameritech
2 Indiana participates in several markets, many of which are intensely competitive. For
3 example, Internet access is extremely competitive, and many competitors, such as cable
4 modem service providers, are providing services that are entirely independent from
5 Ameritech Indiana's facilities. Ameritech Indiana also competes vigorously with several
6 other suppliers of wireless services.¹⁷ Enhanced services, too, have several substitutes,
7 such as answering machines for voice mail and PBX systems for Centrex. Very soon,
8 traditional local voice traffic will constitute only a small portion of all
9 telecommunications traffic. It is entirely reasonable to expect that many of the benefits
10 of a merger between Ameritech Indiana and SBC Communications will be passed
11 through by way of competition in these other markets, and not just through basic local
12 service markets.

13 **IV. POTENTIAL FOR DISCRIMINATION**

14 **Q15. DOES THE MERGER POSE ANY CONCERNS ABOUT AMERITECH**
15 **INDIANA'S ABILITY OR INCENTIVE TO DISCRIMINATE AGAINST**
16 **POTENTIAL COMPETITORS?**

17 A15. No. First, as discussed in greater detail below, Ameritech Indiana has neither the
18 incentive nor ability to discriminate against potential competitive entrants into Ameritech
19 Indiana's local markets. Second, the merger does not increase the incentive or ability to
20 engage in either price or non-price discrimination. The merger will not increase market

¹⁷ Cooper, p. 13; Selwyn/Baldwin, p. 72.

¹⁸ In addition to Ameritech Indiana, wireless service providers in Indiana include: GTE Wireless, Sprint PCS, Cellular One, Nextel, and Omnipoint.

1 power nor provide any incentive for a combined SBC-Ameritech to control prices or
2 attempt to eliminate the development of competition in Indiana's local service markets.

3 **Q16. WILL THE LARGER SIZE OF SBC-AMERITECH AFTER THE MERGER**
4 **RESULT IN A "SPILLOVER" EFFECT THAT WILL INCREASE SBC-**
5 **AMERITECH'S INCENTIVES TO DISCRIMINATE?**

6 A16. The "spillover" effect that opponents generally discuss is that an ILEC does not receive
7 the full benefit to its exclusionary activities since part of the benefit of excluding a
8 competitor from one region is that it is less likely to enter another region. If that is true,
9 the theory goes, then there are externalities to exclusionary activities. Thus, expanding
10 the geographic coverage of the firm internalizes more of those externalities and gives the
11 firm greater incentive to engage in exclusionary activities.¹⁹

12 This theory is purely speculative and is not consistent with today's regulatory and market
13 environment. Opponents generally argue prior to the merger, the firm has incentives and
14 ability to engage in exclusionary activities such as raising input prices, degrading quality,
15 or delaying provisioning of unbundled network elements.²⁰ However, their assertions are
16 unfounded and unsupported by actual evidence. Regulation prohibits the types of
17 discriminatory pricing that opponents allege can occur. TA96 also regulates the
18 provision of unbundled elements to prevent the types of foreclosure opponents allege.
19 Finally, IXCs and other parties closely monitor quality and would detect any attempts by
20 an ILEC to selectively degrade quality.

¹⁹ See IURC Testimonial Staff Report citing Katz and Salop, pp. 14-15; Stahly, p. 18.

²⁰ Stahly, p. 12.

1 Further, even if one accepts that such behavior is possible, there is scant evidence that
2 ILECs have engaged in such behavior in instances where they have faced competition.
3 ILECs compete with other firms in a number of markets, including cellular, intraLATA
4 toll, high capacity transport, and Internet services. There are no indications of
5 exclusionary behavior by ILECs in these markets. In fact, in intraLATA markets, the
6 evidence is that ILECs have lost substantial shares since the implementation of dialing
7 parity. Thus, there is little reason to believe that ILECs have the incentive and ability to
8 engage in exclusionary behavior. There is absolutely no evidence that this situation
9 would change with the merger.

10 **Q17. HOW DOES REGULATION PROHIBIT AMERITECH INDIANA FROM**
11 **ENGAGING IN DISCRIMINATORY BEHAVIOR?**

12 A17. Regulations embodied in TA96 are designed to prevent discrimination in both price and
13 in provisioning. Section 251 of TA96 requires that ILECs provide competitors access to
14 their networks as either unbundled elements or as packages for resale to end-users. TA96
15 also mandates compulsory arbitration when ILECs and competitors cannot agree on rates.
16 In practice, when arbitration is required, state commissions have priced interconnection
17 and UNEs broadly according to the FCC's long run incremental cost methodology.²¹ As
18 the rebuttal testimony of Ameritech Indiana witness, Cheryl Wooley, discusses, there are
19 many safeguards currently in place to ensure that non-discrimination is maintained, and
20 the merger does not change any of the regulatory safeguards.

²¹ See "Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Report and Order," CC Docket No. 96-98, 96-325. (August 1996).

1 **Q18. WILL THE MERGER HAVE ANY EFFECT ON SBC-AMERITECH'S,**
2 **INCLUDING AMERITECH INDIANA'S, ABILITY OR INCENTIVE TO**
3 **DISCRIMINATE?**

4 A18. No. Even if one accepts the opponents' arguments that ILECs, such as Ameritech
5 Indiana, currently have the incentive and ability to engage in exclusionary behavior, it
6 still must be shown that the merger *increases* their incentive and ability to engage in such
7 activities. There is simply no reason to believe that the merger increases the incentive
8 and ability to engage in exclusionary behavior. In fact, the ability of regulators to detect
9 and respond to exclusionary behavior is likely to increase after the merger since there will
10 be more regulatory bodies reviewing the actions of the merged firm than review the
11 actions of either of the existing firms separately. Further, it is important to remember that
12 CLECs and IXC's are ILEC customers in the market for unbundled elements and for
13 access. By reducing the quality of their services, ILECs would simply cause their
14 customers to search for alternatives, such as competitive access providers, or to construct
15 their own facilities.

16 Finally, exclusionary behavior by the merged company would likely have the effect of
17 delaying 271 authorization, and thus, the firm has no incentive to engage in such activity
18 since it would delay the implementation of the National-Local strategy and the ability to
19 provide interLATA services to its customers, including national business customers.

20 **Q19. WILL THE MERGED SBC-AMERITECH HAVE AN INCREASED INCENTIVE**
21 **TO ENGAGE IN A PRICE SQUEEZE?**

22 A19. No. Some of the opponents claim that, because the merged firm will be more likely to
23 receive access charges on both ends of a call, the merger increases the incentive for SBC-

1 Ameritech to engage in a price squeeze if allowed to enter interLATA markets.²² This is
2 an old argument that has been consistently rejected by regulatory bodies, including the
3 FCC in the SBC-Pacific Bell case.²³ SBC-Ameritech would not have the ability or the
4 economic incentive to price squeeze competing long distance carriers if it were allowed
5 to enter interLATA markets.

6 First, the revenue received from access charges is regulated by the Commission.

7 Discrimination through an access charge price squeeze would have the effect of reducing
8 the revenue that Ameritech Indiana receives in access charges and would thus have to be
9 sanctioned by regulators. Second, a price squeeze can only be profitable if (a) the
10 strategy can drive long distance carriers from the market, and (b) there exist sufficient
11 barriers to entry such that the ILEC can raise and maintain high prices to recoup the short
12 run losses it has maintained after competitors exit. The idea that SBC-Ameritech could
13 force AT&T, MCI/WorldCom, Sprint and others out of the long distance market is
14 preposterous given these companies' enormous financial resources and sunk investments
15 in network infrastructure. If SBC-Ameritech did somehow manage to force a long
16 distance competitor out of the market, its network would still be in place, ready for
17 another company to purchase and offer services.²⁴

²² Gillan, p. 26.

²³ See Applications of Pacific Telesis Group and SBC Communications Inc., Memorandum Opinion and Order, CC Dkt. No. 97-286, 12 F.C.C. Rcd. 2624, at ¶ 53 (1997). In a different proceeding, AT&T's economists admitted that access charges are "a peculiar place to be looking for discriminatory practices," because "they are easily quantified and closely monitored." See Affidavit of B. Douglas Bernheim & Robert D. Willig, *United States v. Western Electric Co.*, Civ. No. 92-0192, at 123-24 (Dec. 1994).

²⁴ The FCC comes to a similar conclusion in its Access Charge Reform Order: "[I]t is unlikely that the LEC's interexchange affiliate could engage successfully in predation. At least four interexchange carriers – AT&T, MCI, Sprint, and LDDS WorldCom – have nationwide, or near-nationwide, network facilities that cover every

**Q20. HOW WOULD A PRICE SQUEEZE REDUCE THE REVENUE THAT
AMERITECH INDIANA WOULD RECEIVE FROM ACCESS CHARGES?**

A20. If a vertically integrated LEC acquired an end-user long distance customer, the LEC would forego the access charges it would have received from the end-user's previous long distance carrier, in exchange for the retail long distance revenue from the end-user. If Ameritech Indiana engaged in a price squeeze by charging its retail end-user customer less than access charges plus the non-access network cost of the long distance service, it would forego the revenues (and profits) it had been receiving in the form of access charges. Such a strategy would only be profitable if Ameritech Indiana were able to force competing long distance carriers out of the market, allowing it to reap monopoly rates for long distance services at some point in the future. As explained above, this is utterly implausible.

**Q21. CAN YOU PROVIDE A NUMERICAL EXAMPLE TO SHOW WHY IT WOULD
NOT BE PROFITABLE FOR AMERITECH INDIANA TO TRY TO PRICE
SQUEEZE COMPETITORS IN LONG DISTANCE MARKETS?**

A21. Consider the following hypothetical example. Assume that, for each long distance customer, a long distance carrier pays the ILEC \$8 for access service, while the access service costs \$6 for the ILEC to supply. (Thus, the ILEC receives a contribution of \$2.) Assume further that the non-access network cost of providing retail long distance service is an additional \$4, for either the ILEC or the competitor. (See Figure 2).

LEC's region. These are large, well-established companies with millions of customers throughout the nation. It is unlikely, therefore, that one or more of these national companies can be driven from the market with a price squeeze, even if effectuated by several LECs simultaneously, whether acting together or independently." See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, Notice of Proposed Rule Making, CC Dkt. No. 96-308, at ¶ 137 (released July 18, 1996).

Figure 2
Illustrative Comparison of the ILECs' and IXC's Economic Costs of
Providing Long Distance Service

| Item | ILEC | IXC |
|----------------------------------|------|------|
| Access Cost | \$6 | --- |
| Access Price | --- | \$8 |
| Contribution from Selling Access | \$2 | --- |
| Network Cost | \$4 | \$4 |
| Correct Minimum Retail Price | \$12 | \$12 |

If a customer subscribes to the IXC for its long distance service, the IXC incurs a cost of \$12, \$8 of which is paid to the ILEC. Accordingly, the IXC will earn zero profit if the retail long distance price is \$12. If that customer switches to the ILEC for its long distance service, then the ILEC incurs an additional \$4 in non-access long distance costs. The ILEC also foregoes the \$8 in access charges that it had originally collected from the IXC. Thus, if the ILEC matched the IXC's \$12 price, the ILEC would receive zero additional profit, exactly the same as for the IXC. (That is, the ILEC would receive the same \$2 in contributions it received as an access provider before it acquired the IXC's customer.)

To illustrate further, if the ILEC were to price long distance service at \$11, thereby squeezing the IXC, it would forego \$1 relative to the case where it supplied access and the IXC provided retail long distance service. (That is, the ILEC would receive \$1 in contributions instead of \$2.) Thus, unless the ILEC prices its long distance service at or above \$12, it would be more profitable for the ILEC *not* to provide retail long distance

1 service. In this regard, the ILEC would operate under the same financial incentives as the
2 IXC.

3 In sum, with regard to the current structure of access charges, an ILEC that enters the
4 interLATA market would face exactly the same market share versus profit margin
5 decision that long distance companies face today. Given that a predatory pricing strategy
6 could not force its competitors to exit the interLATA market, any incentives Ameritech
7 Indiana would have to lower prices would constitute the same incentives faced by
8 competing providers. Because forgone access revenues represent a real economic cost,
9 Ameritech Indiana does not enjoy an artificial cost advantage in the provision of
10 interLATA service and has no more economic incentive to price at or below access
11 charges than a long distance carrier does today.

12 **Q22. WOULD THE MERGER MAKE IT MORE DIFFICULT FOR REGULATORS**
13 **TO TRACK AMERITECH INDIANA'S REGULATORY COMPLIANCE?**

14 A22. No. Many opponents claim that the merger increases the ability to discriminate by
15 reducing the number of benchmarks. These arguments do not withstand scrutiny. There
16 are still ample and increasing opportunities for regulators to use benchmarks, including
17 CLECs and intra-company benchmarking. Large companies with extensive
18 telecommunications experience as well as considerable financial resources are entering
19 the local exchange business. These competitors are well positioned to effectively
20 monitor the service they receive from ILECs and will add to the information available to
21 regulators. At the same time, entry into the local exchange market reduces and will
22 ultimately eliminate the need for regulatory benchmarks. Furthermore, there are many

1 regulatory safeguards in place, such as existing interconnection agreements and
2 regulatory requirements that enable the regulators to monitor and, where needed, to
3 enforce the pro-competitive policies that this Commission wishes to maintain. Finally, as
4 IURC Testimonial Staff Points out, much of the commission's benchmarking involves
5 comparison of ILECs within Indiana, and this is unaffected by the merger.

6 **Q23. SHOULD THIS COMMISSION IMPOSE ANY ADDITIONAL SAFEGUARDS**
7 **OR CONDITIONS ON THE MERGER?**

8 A23. No. It should be clear that the merger will not create any potential for discrimination or
9 anti-competitive behavior on the part of SBC-Ameritech. In fact, the merger will have no
10 negative effect on the telecommunications market structure in Indiana. Moreover, there
11 are sufficient regulations in place that prevent Ameritech and SBC, both separately and as
12 a merged entity, from engaging in anti-competitive or discriminatory behavior. For
13 example, the requirements of TA96 and the FCC's subsequent Accounting and Non-
14 Accounting Safeguards Orders ensure that Ameritech, whether it merges with SBC or
15 not, must treat its competitors fairly and provide them with non-discriminatory access to
16 its network. Unnecessary safeguards and conditions would serve only to restrict SBC-
17 Ameritech's flexibility in responding to the changing dynamics of the
18 telecommunications industry, potentially add costs to the provision of service, and
19 hamper SBC-Ameritech's ability to achieve the goals of the merger.

1 **Q24. HAVE YOU REVIEWED THE OHIO STIPULATION AND OPPONENTS'**
2 **COMMENTS RELATING GENERALLY TO THE ISSUES ADDRESSED IN**
3 **THAT AGREEMENT?**

4 A24. Yes, I have. In particular, I note the objections of AT&T's Mr. Gillan on the efficacy of
5 that agreement. First, let me begin by saying that I think that, to the extent that local
6 residential service prices are below cost, competition for residential customers will be
7 less vigorous than it otherwise could be. I, and many others, have made this point
8 repeatedly. That said, I believe that the promotion of residential competition through the
9 special provisions of both the Ohio Stipulation and the Indiana Voluntary Commitment
10 can be very helpful in promoting residential competition. The basis for this conclusion
11 derives from two principal factors. The first important point is that, although some
12 residential customers may have their local service priced below cost, a significant number
13 purchase a variety of services, not just local service, and thus are profitable as a whole
14 from a CLEC's point of view. This is amplified when, as many CLECs are, they also
15 provide interexchange service. The special promotional provisions within the Ohio
16 Stipulation, which are also in the Voluntary Commitment in Indiana, consequently both
17 increase the profitability of these residential customers and, significantly, make profitable
18 those customers at the margin that otherwise might be unprofitable.

19 In addition to the positive profitability aspects of the Ohio Stipulation promotional
20 provisions, it also reduces the resistance that IXC's currently have to taking on residential
21 subscribers in order to prevent Ameritech from satisfying the TA96 Section 271
22 requirements. In order to preserve their lucrative interexchange business by keeping the
23 RBOCs from entering as competitors, IXC's have strong incentives not to serve

1 residential customers and thus be able to claim a lack of competition in that segment of
2 the local market. The promotional provisions of the Ohio Stipulation serve to counter
3 those incentives to some degree. For both of these reasons, I think that the Ohio
4 Stipulation promotional provisions as well as those in the Indiana Voluntary Contract
5 definitely are useful in prodding the level of residential competition in the local service
6 market.

7 **V. CONCLUSION**

8 **Q25. COULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

9 A25. Yes. SBC and Ameritech are participants in a dynamic marketplace, a marketplace
10 completely changed as a result of the explosion of technology and significantly altered
11 customer needs. SBC and Ameritech have found it necessary to position themselves in
12 this new environment by merging their operations. In my view, this makes eminent
13 sense. In addition, I think the merger is highly beneficial from an economic and public
14 policy perspective. The benefits of the merger do not just accrue to the merging firms.
15 They benefit customers and society at large. First, the merger is procompetitive. It will
16 result in these firms being more prepared to compete in the evolving telecommunications
17 marketplace and it will lead to increased competition from their present and future
18 competitors. At the same time, there will be no harm to competition as a result of the
19 merger. The merger is between two non-competing firms and will not have adverse
20 effects.

21 While there are many procompetitive benefits, there also are many other benefits that will
22 stem from the merger. Numerous opportunities exist for the achievement of increased

1 efficiencies, capture of synergies and enhanced innovation. All of these benefits will
2 accrue to customers, both residential and business, as well as to the merging partners.
3 They directly contribute to the procompetitive impact that the merger will have.

4 I have shown in my testimony that the arguments opponents have put forward to stop or
5 encumber the merger are not soundly based in economics and have no real world
6 evidence to support them. I think that society and consumers will only lose if this merger
7 is halted, delayed or encumbered with special conditions. There simply is no reason for
8 any of these negative actions. The Voluntary Commitments proposed by SBC,
9 Ameritech, and Ameritech Indiana increase the benefits from the merger, similar to those
10 in the Ohio Stipulation. In sum, I find that the merger will promote the public
11 convenience and result in the provision of adequate services for a reasonable rate, and I
12 urge the IURC to act swiftly to approve the merger as planned.

Figure 1
Fiber Network Routes of Time Warner and TCG in the Indianapolis MSA

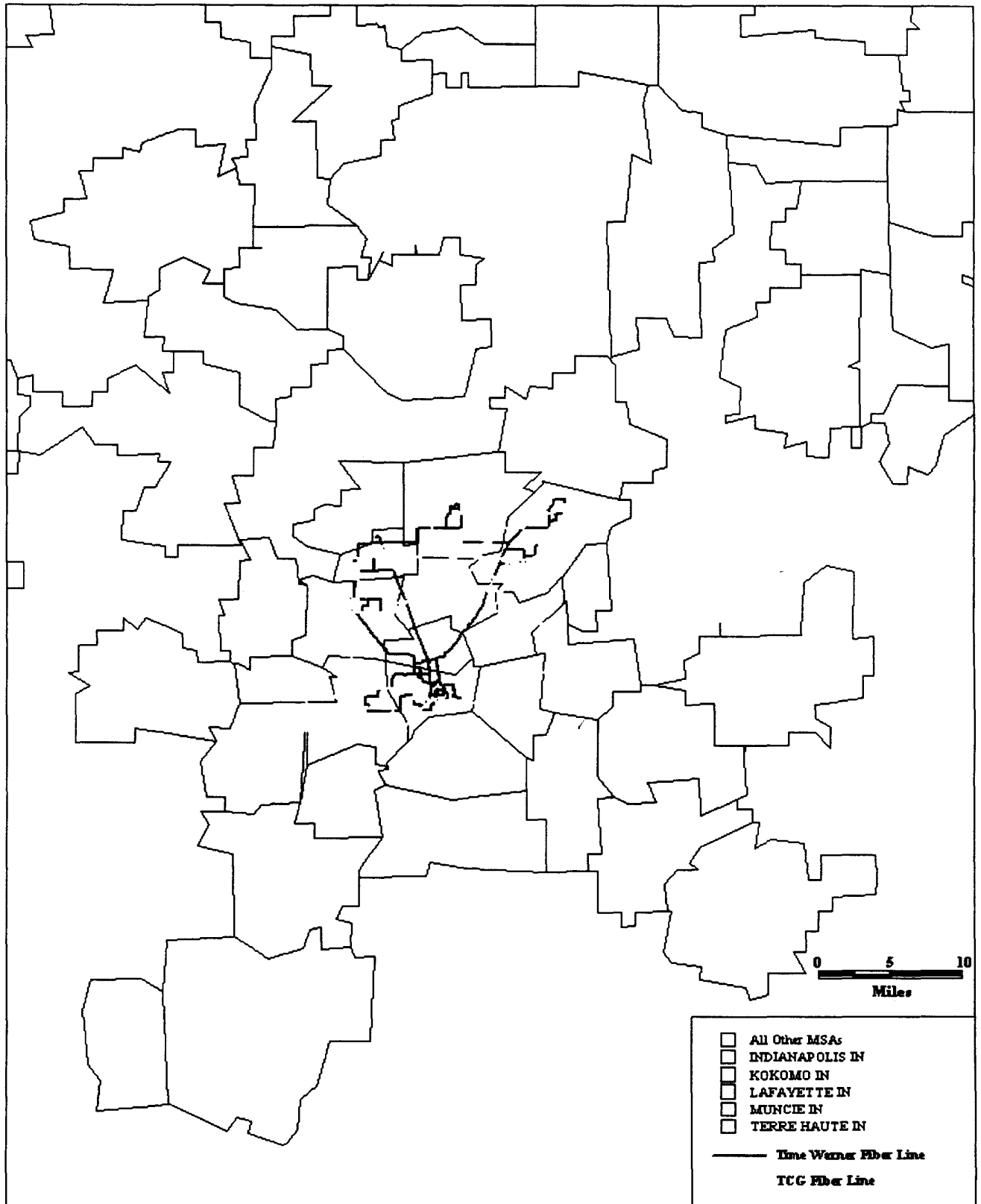


Table 1
Indiana Competitor Summary

| <i>Company</i> | <i>CLLI</i> | <i>City</i> | <i>Switching Equipment</i> | <i>Number of Rate Centers Served</i> |
|---------------------------|-------------|----------------------|--|--------------------------------------|
| AT&T | CHCGIL24DS0 | CHICAGO | Lucent 5ESS | 2 |
| | IPLTINMADS1 | INDIANAPOLIS | Northern Telecom DMS 100 | 43 |
| Focal | | | | |
| | CHCGILAGDS0 | CHICAGO | Northern Telecom DMS 100 | 4 |
| Intermedia Communications | CRMLIN01RS0 | CARMEL | Northern Telecom Remote Switching Center | 1 |
| | FSHRIN01RS4 | FISHERS | Northern Telecom Remote Switching Center | 1 |
| | GNWDIN01RS0 | GREENWOOD | Northern Telecom Remote Switching Center | 1 |
| | IPLSIN74DS0 | INDIANAPOLIS | | 1 |
| McLeodUSA | | | | |
| | IPLTINMYW02 | INDIANAPOLIS | Northern Telecom DMS 250 | 4 |
| Time Warner | | | | |
| | IPLTINSDDS0 | INDIANAPOLIS | Lucent 5ESS | 13 |
| US Xchange | BMTPIN01DS0 | BLOOMINGTON TOWNSHIP | AT&T 5ESS-2000 VCDX | 1 |
| | KNTPIN01DS0 | KNIGHT TOWNSHIP | AT&T 5ESS-2000 VCDX | 1 |
| | MSHWINDQDS0 | MISHAWAKA | Lucent 5ESS | 1 |
| WorldCom | | | | |
| | IPLUINJGDS0 | INDIANAPOLIS | Northern Telecom DMS 100 | 3 |

Analysis includes all Class 5 switches serving Ameritech rate centers in Indiana as reported in LERG, February 1, 1999

Table 2
Competitive Switch Assignment in Indiana

| | Number of Competitors w/ Switches Assigned to Ameritech Ratecenters | Number of Switches Assigned to Ameritech Ratecenters | Lines Addressable by Competitor Switches | Total Lines | Competitor Penetration (% Lines) |
|-------------------------|--|---|---|--------------------|---|
| Indianapolis | 5 | 8 | 802,889 | 867,513 | 92.6% |
| All Other Cities | 4 | 7 | 767,779 | 1,329,430 | 57.8% |
| State Total | 7 | 13 | 1,570,668 | 2,196,943 | 71.5% |

Note: Analysis includes all class 5 switch and rate center assignments reported in Telcordia's Local Exchange Routing Guide (LERG) as of 2/1/99. Line counts are as of year-end 1998. Where wire centers serve more than one rate center, wire centers are assigned to just one rate center to avoid double counting of lines. The following rate centers were considered to be part of Indianapolis: Acton, Carmel, Charlotsvl, Cumberland, Danville, Fairland, Fishers, Greenwood, Indianapls, Mooresvl, Newportalstin, Noblesvl, Oaklandon, Plainfield, Shelbyvl, Sheridan, Westnewton, and Zionsville.

Table 3
Collocated Competition in Indiana

| | Number of Collocated Competitors | Lines Addressable | Total Lines | Competitor Penetration (% Lines) |
|-------------------------|---|--------------------------|--------------------|---|
| Indianapolis | 4 | 736,679 | 867,513 | 84.9% |
| All Other Cities | 2 | 291,731 | 1,329,430 | 21.9% |
| State Total | 5 | 1,028,410 | 2,196,943 | 46.8% |

ATTACHMENT A-TJR

MERGER RELATED JOB CUTS (No Commitments in Most Other Mergers)

| # OF JOBS LOST | MERGING COMPANIES | SOURCE |
|----------------------|-------------------------------|--|
| 600 jobs cut | Anthem/Blue Cross Blue Shield | <i>The Indianapolis Star</i> (01/15/98) |
| 120 jobs cut | Indiana Energy/Sigcorp | <i>Dow Jones News Source</i> (06/14/99) |
| up to 400 jobs cut | BP/Amoco/Arco | <i>Dow Jones News Source</i> (06/15/99) |
| up to 1,000 jobs cut | AOL/Netscape | <i>San Francisco Chronicle</i> (03/25/99) |
| 18,000 jobs cut | Bank America/NationsBank | <i>Dow Jones News Source</i> (01/12/99) |
| 8,000 jobs cut | Citicorp/Travelers | <i>Washington Post</i> (09/18/98) |
| 9,000 jobs cut | Exxon/Mobil | <i>Dow Jones News Source</i> (12/2/98) |
| 1,500 jobs cut | Waste Mgmt/USA Waste Services | <i>Chicago Tribune</i> (6/13/98) |
| 15,000 jobs cut | DEC/Compaq | <i>Knight Rider Wire Report</i> (5/7/98) |
| 4,500 jobs cut | Allied Signal/Honeywell | <i>The Arizona Republic</i> (6/8/99) |

ATTACHMENT A-TJR